

Electric Choice Question 5: *Are electric rates lower in choice states than fully regulated states after considering historical trends as well as rate freezes, price caps, and re-regulation?*

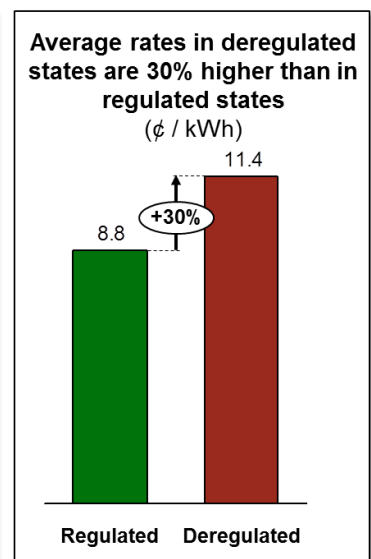
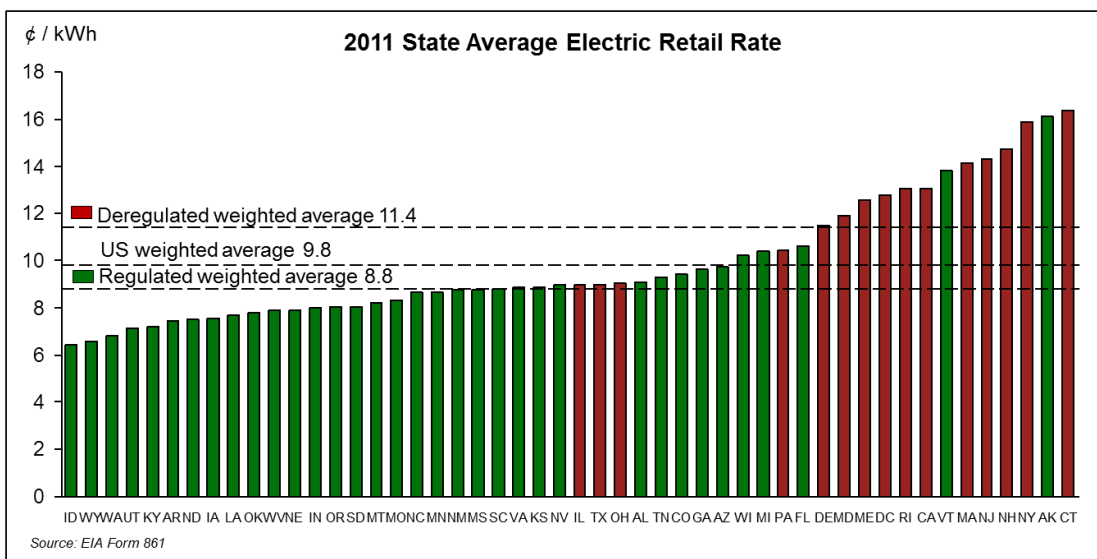
Executive Summary

Electric rates have historically been higher in choice (deregulated) states than in fully regulated states, and remain higher even in today's low commodity price environment.

1. Even in today's low natural gas price environment, electric rates are 30% higher on average in deregulated states than in regulated states. Rates in deregulated states have grown at the same pace as rates in regulated states since deregulation began to take effect around 2000
2. Rate freezes and price caps were often employed in states that deregulated to allow the deregulated market to develop over a transition period prior to full implementation of deregulated rates; deregulated states experienced significant price increases (50%+) after the expiration of rate freezes

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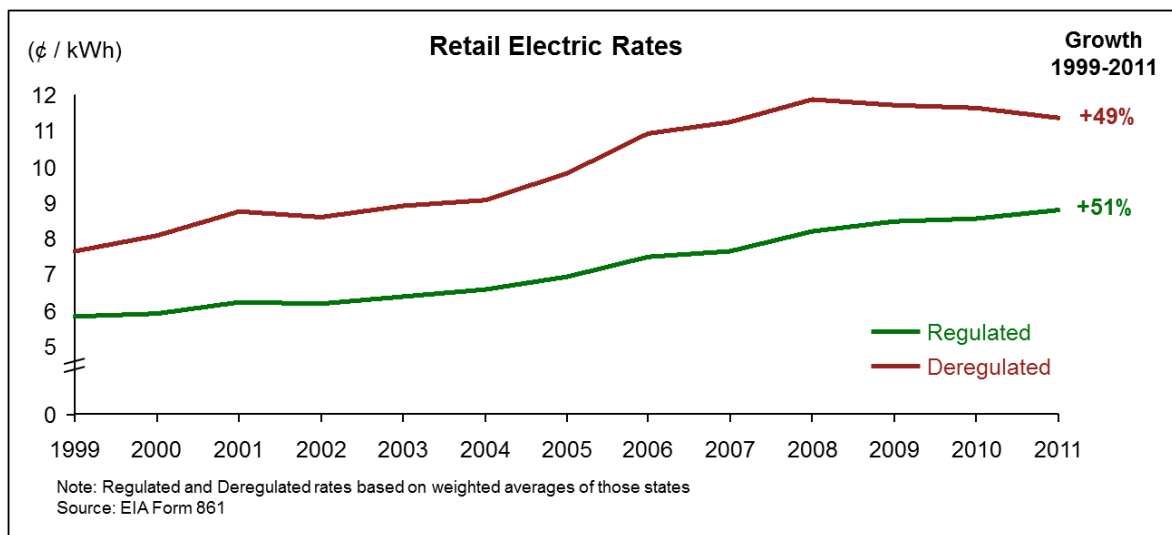
States are classified as regulated or deregulated as described in Electric Choice Question 2.



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Deregulated states have had higher electric rates than regulated states since deregulation began to take effect around 2000, despite various state policies implementing rate freezes and price caps. Both regulated and deregulated rates have grown ~50% since 1999.

Deregulated rates saw increases prior to 2008 as natural gas prices increased and saw decreases after 2008 in conjunction with falling natural gas prices. Regulated rates do not have the commodity exposure and volatility of deregulated rates. Regulated rates have been increasing as utilities have entered an investment cycle for reliability, environmental controls, and renewables.



Deregulation did not lower rates for deregulated states

2. Rate freezes and price caps were often employed in states that deregulated to allow the deregulated market to develop over a transition period prior to full implementation of deregulated rates; deregulated states experienced significant price increases (50%+) after the expiration of rate freezes.

Rate freezes and price caps were often employed in states that deregulated. They were meant to allow the deregulated market to develop over a transition period prior to the full implementation of deregulated rates. These policies were unique by state and sometimes by customer class.

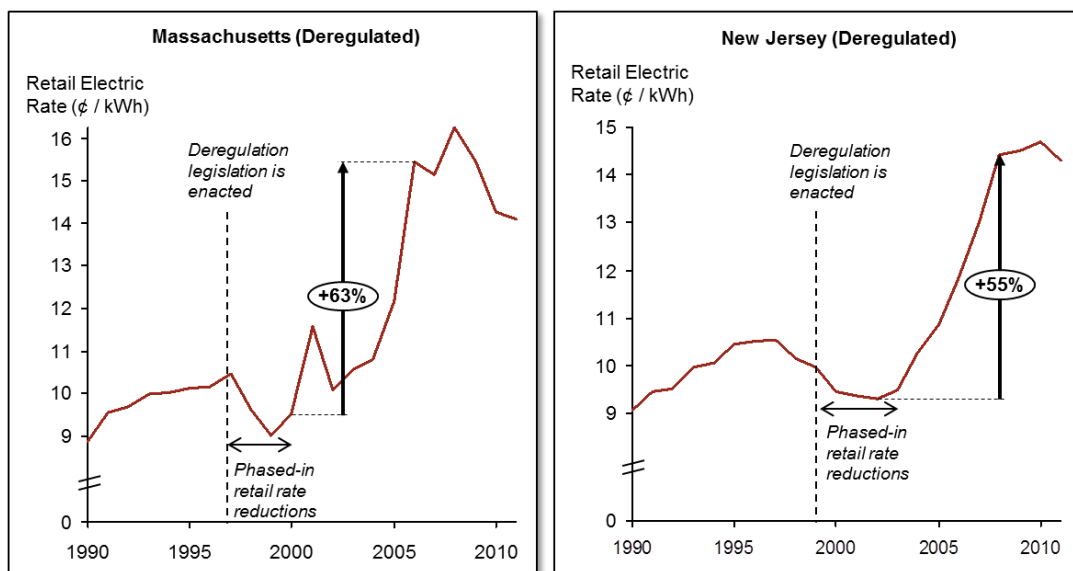
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These rate freeze policies often resulted in a “catch-up” phase after rates were held artificially low:

“By 2003 some 64 rate reduction and freeze plans were in effect in nearly half the states. Initial rate reductions ranged from 3 to 20 percent, ensuring immediate gains to consumers. Freezes extended from two to ten years, during which time consumers would be guaranteed little or no price change regardless of utilities’ underlying costs. If costs fell as expected, unchanged retail price could at least be expected to generate excess funds to help pay utilities for their stranded costs. In fact, costs unexpectedly rose as natural gas prices spiked in 2000-01 and wholesale auction prices for electricity rose. This forced utilities and their regulators to deal with frozen retail rates that in many cases no longer covered utility costs. Many state utility commissions responded by allowing utilities to book as “deferred balances” those costs that exceeded revenues from the frozen rates...The effect of this arrangement was to keep retail prices below their equilibrium level temporarily, but after expiration of the freeze, those prices would jump substantially in a “catch-up” phase”

Source: American Public Power Association, “Restructuring the U.S. Electric Power Sector: A Review of Recent Studies” November 2006 and Virginia State Corporations Commission, “2002 Performance Review of Electric Power Market” August 2002

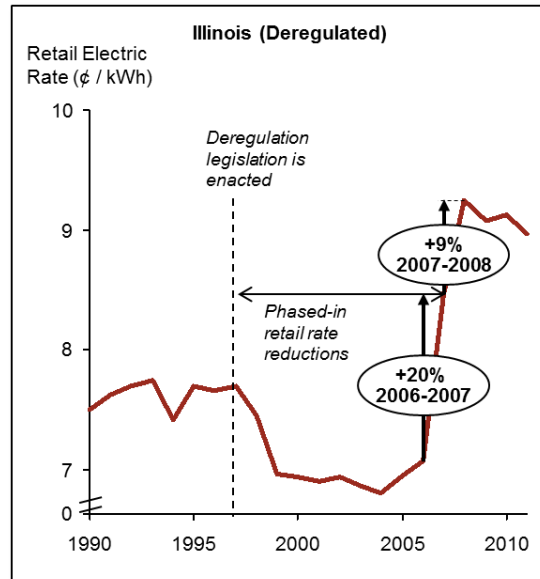
This “catch up” phase was seen in many deregulated states. Rate freezes and discounts benefitted customers in the short-term, however the expiration of freezes resulted in significant rate increases as prices “caught up” to deregulated market rates. The full effect of deregulated market rates resulted in further increases for these states as gas prices rose. Massachusetts and New Jersey faced rate increases over 50% after the expiration of rate freezes.



Source: EIA Form 861

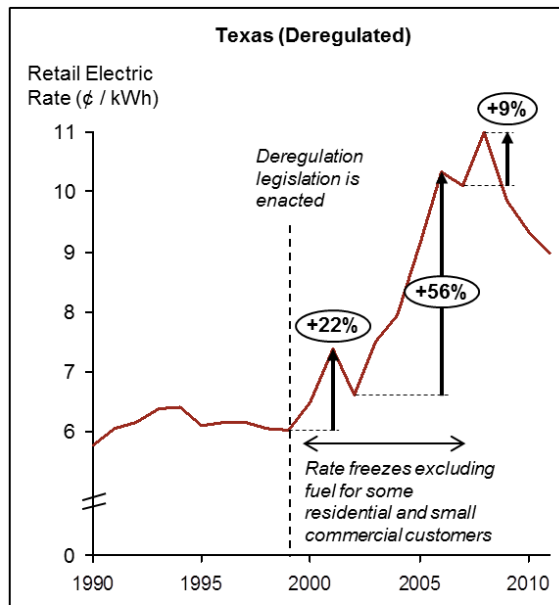
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Illinois rate freezes expired in the high gas price environment and customers experienced a rate increase of 20% in one year to catch up to the deregulated market followed by another 9% the following year as gas prices continued to rise. There was substantial public uproar over the power price spikes.



Source: EIA Form 861

In Texas, rate cap policies did not prevent rate volatility because rate caps were indexed to natural gas, which allowed rates to move with the market as they would have under a deregulated model. Texas illustrates the volatility of deregulated market rates, with periods of short rate reductions followed by larger rate increases.



Source: EIA Form 861